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### Options to Purchase and Successor Landlords

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## E. CONCLUSION

*Mowlem*, it is submitted, was wrongly decided. Not only was the decision unjust to the pursuer, but it also sends an erroneous, and even dangerous, message to the broader community. It states that contractors sued for certain defects in their work may reduce their liability to bear the cost of the remedial work if they can establish that the same work was required by other defects caused by them which the employer could have noticed more than five years before the action commenced<sup>32</sup> or which were built in more than twenty years before the action commenced.<sup>33</sup> Indeed, the implications may reach far beyond the construction industry. For instance, a surgeon sued for certain errors in performing an operation may argue that the ensuing health problems would have independently resulted from further errors by him of which the patient could have become aware of more than three years before the action commenced.<sup>34</sup> The (perceived) victim of a delict or breach of contract, however minor, would accordingly be forced to bring an action if only to preserve the right to get full compensation for other wrongs not yet committed or known to be committed. All these developments would be unedifying and absurd. Fortunately, the decision in *Mowlem* has been appealed.

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*The author is grateful for helpful comments from his colleagues Greg Gordon and Professor Roderick Paisley.*

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# Options to Purchase and Successor Landlords

## A. INTRODUCTION

The recent Outer House decision in *The Advice Centre for Mortgages Ltd v McNicoll*<sup>1</sup> provides sharp focus on an issue of both commercial and theoretical importance: does an option to purchase in favour of a tenant bind a purchaser of the premises? Two legal doctrines are of particular relevance here. The first is whether the term is *inter naturalia* of the lease. The second is the so-called “offside goals” rule.

The case concerned an Edinburgh shop. The defender had become its owner in March 2004. The pursuers argued that they (a) were tenants of the shop and (b) had an option to purchase it. Their problem, however, was that they did not have a formal lease. They sought to rely on unconcluded missives between their solicitors and the agents for the defender’s predecessor as owner, and an unexecuted lease, which they averred they had agreed with that predecessor. Furthermore, they argued that a valid

32 Prescription and Limitation (Scotland) Act 1973 ss 6, 11(3).

33 Prescription and Limitation (Scotland) Act 1973 s 7.

34 Prescription and Limitation (Scotland) Act 1973 s 17.

1 [2006] CSOH 58; 2006 SLT 591.

lease had been constituted by personal bar. Their arguments here, which were unsuccessful, are discussed by Elspeth Reid in her note<sup>2</sup> and no more will be said about them. Rather, the focus will be on the enforceability of the option to purchase in the missives and draft lease. The defender's position was that even if the court had held that a lease was established by personal bar, the option would not be enforceable against her as a successor landlord.

## B. THE *INTER NATURALIA* ISSUE

Lease law is seriously under-researched in Scotland, and there is much work needing to be done on important questions. One of these is the circumstances in which terms in a lease transmit to successors of the original landlord and tenant. The rule here is that they do if they are *inter naturalia* of the lease. "This appears to mean", notes a leading textbook,<sup>3</sup> "that in order to bind a singular successor the condition must be one commonly occurring in the type of lease concerned." For example, patently the tenant's obligation to occupy the property and pay the rent will fall into the *inter naturalia* category. As a general statement, however, each clause must be considered individually. The result may not be coherent. In *Optical Express (Gyle) Ltd v Marks & Spencer plc*<sup>4</sup> it was held in the Outer House that an exclusivity clause providing that the tenants were to be the only opticians in the Gyle Centre in Edinburgh was not enforceable against a successor landlord. As Angus McAllister has noted,<sup>5</sup> the earlier Inner House case of *Davie v Stark*,<sup>6</sup> in which a similar clause was duly enforced in such circumstances, was not cited to the court. This is because the *inter naturalia* point was not specifically argued there; thus one does not find the case discussed in texts on the subject.<sup>7</sup> In contrast, in the recent case of *Warren James (Jewellers) Ltd v Overgate GP Ltd*<sup>8</sup> it was accepted without argument that an exclusivity clause did transmit.

There is a more fundamental question. Is the test properly whether the condition is a commonly occurring one?<sup>9</sup> In the *Optical Express* case Lord Macfadyen commented that the matter is "primarily a question of the nature of the obligation".<sup>10</sup> This view mirrors the position in South Africa, where transmission of a term depends on an objective test of whether it is "material" or "collateral" to the lease.<sup>11</sup> It might also be asked whether the intention of the parties is relevant. For example, the test for the

2 See 437 below.

3 G C H Paton and J G S Cameron, *The Law of Landlord and Tenant in Scotland* (1967) 95.

4 2000 SLT 644.

5 A McAllister, *Scottish Law of Leases*, 3rd edn (2002) para 2.35.

6 (1876) 3 R 1114.

7 For example, Paton and Cameron, *Lands and Tenant* 94-97. Cf J Rankine, *The Law of Leases in Scotland*, 3rd edn (1916) 475-479 and 220.

8 [2005] CSOH 142.

9 I am indebted to Mr Peter Webster for sight of his research in this area and his comments on a draft of this article.

10 2000 SLT 644 at 650.

11 P J Badenhorst, J M Pienaar and H Mostert, *Silberberg and Schoeman's The Law of Property*, 4th edn (2003) 407.

creation of real burdens is whether the parties to the deed have sought to create such an obligation, as evidenced by adhering to the correct rules on constitution.<sup>12</sup> Real burdens, however, are limited by the rule requiring praedial benefit<sup>13</sup> and one can argue cogently on that basis that intention should be incapable of making a collateral term material. Here, however, is not the place to reformulate the Scots law, although, there is no doubt that the parameters of the *inter naturalia* doctrine are of great concern in commercial practice.

For present purposes the issue is solely whether an option to purchase will bind a successor landlord. The leading authority here is *Bisset v Magistrates of Aberdeen*.<sup>14</sup> There, a 999 year lease contained an obligation on the landlords to deliver a feu charter to the tenants on request. It was held that the clause did not bind the landlords' successors. In the words of Lord Moncreiff:<sup>15</sup>

It is an obligation to alter the tenure from one of lease to one of feu. This can scarcely be said to be *inter naturalia* of a lease, and if it is not it will not affect singular successors.

This passage was quoted approvingly by Lord Drummond Young, the judge in *Advice Centre for Mortgages*, who concluded that the option in the offer of lease was not binding on the defender.<sup>16</sup>

The decision in *Bisset* leaves open the possibility of an option to purchase being regarded as *inter naturalia* if this can be shown as "customary and usual"<sup>17</sup> for the type of lease in question. The pursuers in *Advice Centre for Mortgages*, however, made no averments to this effect.<sup>18</sup> Rather their counsel merely submitted that such options were common and that this fact could be within judicial knowledge. Lord Drummond Young rightly dismissed this argument, commenting that:<sup>19</sup>

while options to purchase are encountered, many leases do not contain such options. Indeed, in leases granted by investment institutions, which are very common, it is difficult to imagine why an option to purchase should be common practice.

A party trying to show that such an option is, on the facts, *inter naturalia* of a lease is likely to face a difficult task.<sup>20</sup>

12 See now in particular the Title Conditions (Scotland) Act 2003 ss 1-5.

13 2003 Act s 3(1)-(4).

14 (1898) 1 F 87.

15 At 90.

16 [2006] CSOH 58 at para 38.

17 *Bisset* (1898) 1 F 87 at 90 per Lord Moncreiff. In South Africa, it has been argued that an option will bind a successor landlord if it can be shown to be an integral part of the lease: see A J Kerr, *The Law of Sale and Lease*, 3<sup>rd</sup> edn (2004) 441-442. Where the land is transferred for no consideration, the successor is always bound: *Van der Pol v Symington* 1971 (4) SA 472. This may be because he or she is considered to be equivalent to an acquirer with knowledge of the option, a matter discussed below.

18 [2006] CSOH 58 at paras 37 and 39.

19 Para 40.

20 As has been commented, "it is almost certainly not": K G C Reid and G L Gretton, *Conveyancing 2004* (2005) 106.

### C. THE RELEVANCE OF BAD FAITH

A separate argument of the pursuers was that because the defender knew about the option when she acquired the property, she could therefore be regarded as in bad faith. Accordingly, she was bound by the option. In other words, she was bound to sell the property to the pursuers if they sought to exercise the option.

In principle, it is difficult to see why a party can be bound by an obligation undertaken by another merely because he or she has knowledge of it. The basis, however, of the pursuers' argument was the so-called "offside goals" rule. The classic example is the double sale: where A agrees to sell property to B but then transfers it to C, B can reduce the conveyance to C if C can be shown to have been in bad faith (i.e. aware of the earlier agreement with B).<sup>21</sup> The doctrine, however, is wider than that. It will apply, for example, if, rather than ownership being transferred to C, he or she is granted a standard security by A. B will be able to set that security aside on the basis of C's bad faith.<sup>22</sup>

The doctrine was first subjected to a sustained analysis by Professor Kenneth Reid in the 1990s.<sup>23</sup> The last few years have seen much scholarship being devoted to a most interesting but, in terms of conceptual foundation, elusive subject.<sup>24</sup> It seems to be generally accepted that a prerequisite for the offside goals rule to apply is that the grant of a right to C must breach a prior obligation between A and B. Thus in the case of a double sale, A breaches his obligation to transfer a good title to B by conveying to C. To paraphrase Lord Rodger of Earlsferry, there is an attempt to cut out B.<sup>25</sup> The problem for the pursuers in this case was the absence of a breach or attempt to cut out. The defender acquired ownership of the property. But nothing, express or implied, in the missives between the transferor and the pursuers or in the unsigned lease prevented transfer. In the words of Lord Drummond Young: "what matters is that the intervention of equity on the ground of bad faith is only warranted by the breaching of an existing obligation."<sup>26</sup> He continued, after reference to the work of Professor Reid:<sup>27</sup>

The sale of property ... to the defender did not involve the seller in any breach of its existing obligations. No such breach is averred and it is difficult to see how any breach could be averred. The right to sell is one of the most normal incidents of property, and in my opinion clear wording or a clear implication would be required to restrict or remove that right.

21 The leading case is of course *Rodger (Builders) Ltd v Fawdry* 1950 SC 483.

22 *Trade Development Bank v Crittall Windows Ltd* 1983 SLT 510.

23 K G C Reid, *The Law of Property in Scotland* (1996) paras 695-700.

24 J Blackie, "Good faith and the doctrine of personal bar", in A D M Forte (ed), *Good Faith in Contract and Property Law* (1999) 129 at 147-150; D L Carey Miller, "Good faith in Scots property law", in Forte (ed), *Good Faith in Contract and Property Law* 103 at 107-110; S Wortley, "Double sales and the offside trap: some thoughts on the rule penalising private knowledge of a prior right" 2002 JR 291; D A Brand, A J M Steven and S Wortley, *Professor McDonald's Conveyancing Manual*, 7<sup>th</sup> edn (2004) paras 32.52-32.62; R G Anderson, "'Offside goals' before *Rodger Builders*" 2005 JR 277; D L Carey Miller with D Irvine, *Corporeal Moveables in Scots Law*, 2<sup>nd</sup> edn (2005) paras 8.31-8.32; D L Carey Miller, "Mala fide transferees in Scotland: the case of a registered 'offside goal'" (2005) 16 Stellenbosch LRev 318.

25 *Burnett's Trustee v Grainger* 2004 SC (HL) 19 at 39.

26 [2006] CSOH 58 at para 46.

27 Para 47.

In his judgment, Lord Drummond Young had to deal with the one authority which supported the view that the defender was bound, *Davidson v Zani*.<sup>28</sup> There, missives entered into in relation to a lease of shop premises in Aberdeen gave the tenant an option to purchase at the end of the lease. Prior to that date the shop was sold to a third party, who was aware of the option. The Sheriff Principal held that the facts fell within the scope of the offside goals rule and that the acquirer's knowledge meant that she was bound by the option. *Bisset* was cited to him, but he held that it was not relevant to the matter at hand, as it was about the construction of a lease. In *Davidson* the obligation was in the missives between the parties, not the actual lease.

Lord Drummond Young concluded that *Davidson* was incorrectly decided.<sup>29</sup> The sale of the shop was not in breach of the missives. Moreover, the Sheriff Principal did not give *Bisset* its "proper significance".<sup>30</sup> If an option to purchase is not *inter naturalia* of the lease, it cannot bind successor landlords, whether they have knowledge of it or not. As noted, in *Davidson* the option was not even in the lease.<sup>31</sup> Now, of course, the effect of the offside goals rule is to make a personal right binding on a third party because of their knowledge, in contrast to the general rule of property law that only real rights bind third parties. Why does that rule not apply here? The answer, it is submitted, is that the primary obligation on third parties arising under the rule is a negative one, i.e. not to breach the prior existing right.<sup>32</sup> Making the option bind the acquirer would be to place a positive obligation on him, i.e. to sell the property, in a situation where there is no breach. The result is to override the *inter naturalia* doctrine. That must be wrong.<sup>33</sup> To put it another way, the option is binding upon the initial landlord and no-one else. The offside goals rule should not alter that result.

The offside goals rule may be inapplicable here for a further reason, namely that the option does not confer a *right* upon a tenant, but a *power* which he or she can exercise, and until the power is exercised there is no right which is capable of being breached. Lord Drummond Young noted that the right/power "distinction does not appear to have been taken in any of the cases".<sup>34</sup> This question must be left for the future.

Lord Drummond Young's opinion is a helpful statement of the application of the offside goals rule to options in leases. Nevertheless, in this very difficult area, it is

28 1992 SCLR 1001.

29 Para 51. The same conclusion is reached by K G C Reid and G L Gretton, *Conveyancing 2004* (2005) 106.

30 Para 51.

31 This is rather similar to *Optical Express (Gyle) Ltd v Marks and Spencer plc* 2000 SLT 644 where an exclusivity clause which the tenants unsuccessfully argued was binding on new landlords as well as on other tenants by virtue of the "offside goals" rule was in a back letter and not the lease. See A J M Steven, "Keeping the goalposts in sight" 2000 SLT (News) 143.

32 Of course there may be a subsidiary positive obligation: for example, in the double sale, C may be required to convey to B. See Reid, *Property* (n 23) para 700.

33 See also S Brymer, "Enforcing commercial lease terms against successor landlords" (2000) 49 *Greens Property Law Bulletin* 4, which was cited by Lord Drummond Young in para 51 of his judgment. A different view has been expressed in South Africa, but this seems difficult to reconcile with the fact that its equivalent of the offside goals rule requires infringement of a prior obligation: see Badenhorst, Pienaar and Mostert, *Law of Property* (n 11) 91 and 407.

34 [2006] CSOH 58 at para 51.

possible to advance alternative arguments.<sup>35</sup> In particular it can be suggested that by selling the property the original landlord makes it impossible to fulfil his or her obligation under the option. The sale can therefore be analysed as an anticipatory breach of that obligation. That argument depends on how the option itself is analysed. It can be regarded as enforceable only so long as the original landlord remains owner and therefore automatically extinguished upon the transfer of the property. The alternative view, which accords with a general principle advanced by Gloag,<sup>36</sup> is that the original landlord remains bound and will therefore be liable for breach of contract when he or she cannot perform. If that second view is correct, however, the obvious issue is what the original landlord can do so as not to be in breach. The matter should be dealt with expressly in the lease. Assuming, however, it is not, then one answer is that to avoid breach the original landlord must refrain from transferring. This seems unacceptably restrictive. A second answer is that there can be transfer but the successor landlord must be made to agree that the option is binding upon him or her. The effect, however, would be to undermine the *inter naturalia* doctrine. For that reason, the present writer prefers the view that the option is only binding upon the original landlord so long as he or she is owner.

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## Personal Bar: Three Cases

*One-half the troubles of this life can be traced to saying yes too quickly and not saying no soon enough.*<sup>1</sup>

The “trouble” which Scots law commonly throws in the way of the rash and the hesitant is of course a plea of personal bar. The three cases considered below come from different conveyancing contexts, but for all, in one way or another, the “trouble” came from “not saying no soon enough”. But as so often, the plea of bar ended in failure.

### A. STATUTORY BAR AND LEASES

The first case involved the statutory form of personal bar as set out in section 1(3) and (4) of the Requirements of Writing (Scotland) Act 1995. In the decade since these provisions were enacted surprisingly little litigation has occurred. *The Advice Centre for Mortgages v McNicoll*<sup>2</sup> is the first case to offer extended analysis in relation to leases. The pursuers sought a declarator that they were tenants of a shop property, basing

<sup>35</sup> See in this regard the discussion of the position in England in S Tromans, “Options: as safe as houses?” (1984) 43 CLJ 55.

<sup>36</sup> W M Gloag, *Contract*, 2nd edn (1929) 264.

<sup>1</sup> Josh Billings.

<sup>2</sup> [2006] CSOH 58; 2006 SLT 591.